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The Director of Central Intelligence
Washington, D.C. 20505

National Intelligence Council

NIC #03642-84/1
12 September 1984

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: The Costs of the Soviet Empire: A Rejoinder

1. Attached is a rejoinder to my memorandum "Perspectives on the Economic Burden of the Soviet Empire" of 11 June, prepared [redacted] [redacted], who asked that it be distributed to the recipients of my memorandum. As you will see [redacted] treats my memo as if it were intended solely as a critique of his paper. [redacted] Although I prominently discussed my conceptual problems with his study, the primary purpose of my memo was to examine different facets and perspectives on the problem so that the US Government would have a better understanding of Soviet behavior and on whether and how we may be able to exploit this behavior. I did not argue that a respectable theoretical argument could not be made for the [redacted] approach, but rather that this approach is only one of many that could be used, and that it can give misleading results if the estimated "burden of empire" is added to the defense burden or if it is treated as representative of Soviet perceptions.

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2. As you will see, the [redacted] critique is defensive and at times deals with nitpicks rather than important differences. Apart from the nitpicks, three major differences emerge:

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- o [redacted] believes it is "appropriate and useful to think of the empire as an enterprise, and to think of the costs of managing an empire as analogous to the costs of managing a firm." This economic abstraction may be useful to help in establishing criteria for measuring costs, but in my opinion it ignores the considerable differentiation in Soviet policies and institutional dealings with various groups of countries--Communist countries, other clients, and Third World

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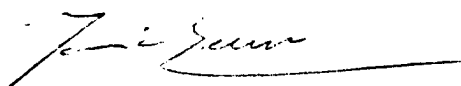
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client states. This differentiation seems to me critical in any understanding not only of what costs Moscow is willing to incur, but also of how it assesses these costs.

- o [] believes, and I agree, that valuing Soviet trade with client states in terms of the best prices Moscow could have received or paid for the same products in the West is a theoretically legitimate way to calculate price subsidies, which are in turn the major element in the cost of empire. In a Communist state, with a command economy heavily insulated from the Western market, however, it is not at all evident that potential trade with the West will always be viewed as the most relevant alternative for trade with the "empire." 25X1
- o Although [] does not explicitly add his estimates of the "burden of empire" in rubles to the defense burden, he strongly suggests that this should be done. I believe that this procedure would yield inflated measures of economic burden. The calculation of defense burden is designed to reflect the costs of the factors of production (labor, capital, and land) used for defense purposes. A comparable measure of the burden of empire would be to subtract the domestic factor cost of producing exports to the empire from the factor cost of producing domestic substitutes for imports from the empire. This is a very different concept from that used [] and I suspect would yield a much smaller measure of burden. 25X1

3. I will be talking to [] on these and related issues 25X1

[] 25X1



Maurice C. Ernst

Attachment,
As stated

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